NOS.

241

325

336

342

Nos. 241, 620, 660, 642

JOHN F. FEY, Clerk

In the Supreme Court of the United States

OCTOBER TERM, 1967

ELMO E. ALLEN AND GEORGE GREENWALD, ETC., ET AL.,
PETITIONERS
v.
BEN WILLIAMSON, JR., ET AL.

VANSTON BONDHOLDERS PROTECTIVE COMMITTEE,
PETITIONER
v.
COLUMBIA GAS SYSTEM, INC., ET AL.

COMMITTEE, ETC., PETITIONERS
v.
COLUMBIA GAS SYSTEM, INC., ET AL.

PAUL E. KERR, ETC., PETITIONER
v.
BEN WILLIAMSON, JR., ET AL.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

EDWIN M. ZIMMERMAN,
Solicitor General,
Department of Justice, Washington 25, D. C.

THOMAS G. MEEKER,
General Counsel,
DAVID FERBER,
Assistant General Counsel,
AARON LEVY,
Special Counsel,
Securities and Exchange Commission,
Washington 25, D. C.

INDEX

	Page
Opinions below	1
Jurisdiction	2
Questions presented	2
Statement	3
Discussion	10
Conclusion	23

CITATIONS

Cases:

American Fuel and Power Co., In re, 122 F. 2d 223 — 6, 10

American Iron and Steel Mfg. Co. v. *Seaboard Air Line Ry.*, 233 U. S. 261 — 15, 16

American United Mutual Life Insurance Co. v. *City of Avon Park*, 311 U. S. 138 — 11

Bowman v. *Loperena*, 311 U. S. 262 — 22

Central Trust Co. v. *Condon*, 67 Fed. 84 — 16

Coder v. *Arts*, 213 U. S. 223 — 16

Columbia Gas & Electric Corp. v. *American Fuel and Power Co.*, 322 U. S. 379 — 3

Columbia Gas & Electric Corp. v. *United States*, 151 F. 2d 461 — 5, 6, 10

Columbia Gas & Electric Corp. v. *United States*, 153 F. 2d 101, certiorari denied, 329 U. S. 737 — 6

Commonwealth v. *Thompson*, 190 F. 2d 10, certiorari denied, 342 U. S. 918 — 14

Consolidated Rock Products Co. v. *DuBois*, 312 U. S. 510 — 16

Deep Rock Oil Corp., In re, 113 F. 2d 266, certiorari denied, 311 U. S. 699 — 12, 13

Group of Institutional Investors v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Company*, 318 U. S. 523 — 16

Hartford-Empire Co. v. *United States*, 323 U. S. 386 — 10

Inland Gas Corp., In the Matter of, 187 F. 2d 813 — 6, 8, 10, 19, 20

435790 - 57 — 1

Cases—Continued

	Page
Inland Gas Corp., In re, 211 F. 2d 381, certiorari denied, 348 U. S. 840	6, 8, 20
Inland Gas Corp., In re, 217 F. 2d 207	6
Jamison v. *Federal Deposit Insurance Corp.*, 149 F. 2d 199	15
Johnson v. *Norris*, 190 Fed. 459, appeal dismissed for lack of jurisdiction, 232 U. S. 715	16
Kansas City Journal-Post Co., In re, 144 F. 2d 791	21
Land v. *Dollar*, 330 U. S. 731	18
Larson v. *Domestic & Foreign Commerce Corp.*, 337 U. S. 682	18
Macomb Trailer Coach Co., In re, 200 F. 2d 611, certiorari denied *sub nom. McInnis* v. *Weeks*, 345 U. S. 958	16
National Foundry Company of New York v. *Director of Internal Revenue*, 229 F. 2d 149	14
New York v. *Saper*, 336 U. S. 328	11, 14, 15
New York Trust Co. v. *Detroit, T. & I. Ry. Co.*, 251 Fed. 514	15
North American Company, The, 33 S. E. C. 632	21
Pavone Textile Corp. v. *Bloom*, 302 N. Y. 206, 97 N. E. 2d 755, affirmed *sub nom. United States* v. *Bloom*, 342 U. S. 912	14
Pepper v. *Litton*, 308 U. S. 295	11–12, 21
Pfister v. *Northern Illinois Finance Corp.*, 317 U. S. 144	22
Progress Shoe Co., Application of, 107 F. Supp. 114	15
R. F. C. v. *Denver & Rio Grande Western Railroad Co.*, 328 U. S. 495	16
Sampsell v. *Imperial Paper and Color Corp.*, 313 U. S. 215	11
Securities and Exchange Commission v. *Louisiana Public Service Commission*, 353 U. S. 368	22
Sexton v. *Dreyfus*, 219 U. S. 339	16
Squire v. *American Express Co.*, 131 Ohio St. 239, 2 N. E. 2d 766	15
Sword Line, Inc. v. *Industrial Commissioner of the State of New York*, 212 F. 2d 865, certiorari denied, 348 U. S. 830	14
Taylor v. *Standard Gas & Electric Co.*, 306 U. S. 307	12, 20
Ticonic National Bank v. *Sprague*, 303 U. S. 406	16

Cases—Continued Page
United States v. *Edens*, 189 F. 2d 876, affirmed, 342 U. S. 912 ..... 11, 14
United States v. *General Engineering & Mfg. Co.*, 188 F. 2d 80, affirmed, 342 U. S. 912 14
United States v. *General Motors Corp.*, 323 U. S. 373 .. 18
United States v. *Paddock*, 187 F. 2d 271 14
Vanston Bondholders Protective Committee v. *Green*, 329 U. S. 156 ..... 3, 17
Statutes:
Bankruptcy Act:
§ 64 (a) (4) (11 U. S. C. 104a (4)) 11, 14
§ 208 (11 U. S. C. 608) 3
Public Utility Holding Company Act of 1935, 49 Stat. 803, Sec. 11 12
28 U. S. C. 1254 (1) 17
Miscellaneous:
3 Collier on *Bankruptcy* (14th ed.) ¶ 57.14, notes 6–7; ¶ 65.06, notes 1–2 12
6 Collier on *Bankruptcy*, ¶ 9.15, note 16 12
Securities and Exchange Commission's Corporate Reorganization Release No. 90 (1952) 8

In the Supreme Court of the United States

OCTOBER TERM, 1957

No. 241

ELMO E. ALLEN AND GEORGE GREENWALD, ETC., ET AL., PETITIONERS

v.

BEN WILLIAMSON, JR., ET AL.

No. 325

VANSTON BONDHOLDERS PROTECTIVE COMMITTEE, PETITIONER

v.

COLUMBIA GAS SYSTEM, INC., ET AL.

No. 336

COMMITTEE, ETC., PETITIONER

v.

COLUMBIA GAS SYSTEM, INC., ET AL.

No. 342

PAUL E. KERN, ETC., PETITIONER

v.

BEN WILLIAMSON, JR., ET AL.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

OPINIONS BELOW

The opinions of the Court of Appeals are reported at 241 F. 2d 374 (Pet. No. 342, pp. 23–43). The District Court filed no opinion.

JURISDICTION

The judgment of the Court of Appeals was entered on February 14, 1957 (Pet. No. 342, p. 44).

A petition for rehearing was filed on March 5, 1957, and was denied on May 8, 1957 (Pet. No. 342, pp. 45–46). The petitions for writs of certiorari were filed as follows: No. 325, July 30, 1957; No. 336, August 1, 1957; No. 342, August 5, 1957.

Petitioners in No. 241 did not join in the petition for rehearing. The time for these petitioners to file a petition for a writ of certiorari was extended by order of Justice Burton to July 13, 1957. The petition was filed on July 1, 1957.

The jurisdiction of this Court is invoked under 28 U. S. S. 1254 (1).

QUESTIONS PRESENTED[1]

In Nos. 325, 336 and 342

1. Whether a reorganization court can compel subordination of the claims of a controlling corporation, found guilty of inequitable conduct, to post-reorganization interest on (as well as to the principal of) claims of public unsecured creditors.

In No. 241[2]

2. Where inequitable conduct of a controlling corporation resulted in injury to all security holders of an enterprise, including common stockholders, whether

[1] Other questions are raised by the petition in No. 274, to which a separate response is being filed by the Solicitor General.

[2] For the reasons stated *infra*, p. 19, n. 20, the Commission does not support the grant of certiorari as to the other question tendered by the petition for No. 241.

a reorganization court may subordinate the claims and interests of the controlling corporation not only to the claims of creditors but also to the interests of common stockholders to the extent that such subordination may be equitable.

STATEMENT

This case arises out of proceedings under Chapter X of the Bankruptcy Act involving the debtors Inland Gas Corp. ("Inland"), Kentucky Fuel Gas Corp. ("Kentucky Fuel"), and American Fuel and Power Co. ("American Fuel").[3] The Securities and Exchange Commission is a party to the proceedings pursuant to Section 208 of the Bankruptcy Act (11 U. S. C. 608). These proceedings are a continuation of proceedings under former Section 77B of the Bankruptcy Act, which in turn succeeded equity receiverships of the debtors that had been instituted in 1930 and 1931.

It has previously been established that the receivership proceedings had been caused by Columbia Gas and Electric Corp. (since renamed the Columbia Gas System, Inc. and referred to herein as "Columbia"), which had control of these debtors, in order to prevent competition with certain of Columbia's subsidiaries. See *Columbia Gas & Electric Corp.* v. *United States,* 151 F. 2d 461. The opinion of the court below in that case, approving numerous findings

[3] Problems arising in these proceedings were considered by this Court in *Columbia Gas & Electric Corp.* v. *American Fuel and Power Co.*, 322 U. S. 379, and in *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156.

of the District Court, is (unless otherwise indicated) authority for the facts set forth in this memorandum.

Inland and Kentucky Fuel were incorporated in 1927 and 1928, respectively, to produce natural gas and acquire gas properties. They were financed by the public sale of their debt securities. The common stocks of each were issued to the same group of promoters and underwriters. American Fuel was organized in 1928 as a holding company to consolidate operations and management. Its debt securities were also sold to the public and its common stock was exchanged for common stock of Inland and Kentucky Fuel. These companies, together with several small corporations wholly owned by American Fuel, constitute the American Fuel system, which has at all times been operated as an integrated enterprise.

Prior to the organization of this system, Columbia had virtual freedom from competition in the field occupied by its subsidiaries in Kentucky, Ohio, and West Virginia. But thereafter it lost certain of its large industrial customers to the American Fuel system. In January 1930, having noted that Inland and Kentucky Fuel had sustained substantial operating losses and that default upon their bonds might be anticipated, Columbia began to purchase Inland and Kentucky Fuel bonds on the open market, so that it would be in a position to force foreclosure and sale of their properties. These purchases continued until Columbia had acquired in excess of 25% of the bonds of both companies.

Meanwhile, Hope Engineering Co., which had been supervising and managing the operations of Inland

and Kentucky Fuel, determined that the only hope of survival of the American Fuel system was by financing a large expansion of its business. Together with two other companies, it formed a syndicate to construct a natural gas transmission line to the City of Detroit, which was not then served with natural gas, and it agreed to provide funds sufficient to prevent immediate default on the obligations of American Fuel, Inland, and Kentucky Fuel. The syndicate acquired a majority of American Fuel's common stock, giving it control of the system. As the court below previously noted (*Columbia Gas & Electric Corp.* v. *United States,* 151 F. 2d 461, 464): "The Syndicate was considered to be a combination of sufficient financial strength and business experience to foreshadow success of the Detroit project and so prevent the impending financial collapse of the American Fuel System."

Shortly thereafter, Columbia, which had also planned to supply natural gas to the Detroit area, purchased the syndicate's entire holdings in the American Fuel system, giving the syndicate a clear profit of $350,000, as well as agreeing to hold its members harmless by reason of obligations they had undertaken, and otherwise obligating itself to Hope Engineering Company in a manner which it ultimately settled by the payment of $400,000. Upon obtaining control, Columbia brought about receivership proceedings and the American Fuel system's Detroit project was abandoned.

The court below found "that the Detroit line would have served American Fuel and its subsidiaries, and

in its successful completion lay their only hope for escape from impending financial disaster." *Columbia Gas & Electric Corp.* v. *United States, supra,* 151 F. 2d at 468. It added (*id.* at 469): "The prospect of recovery and possible profit in what may now seem to have been initially an improvident investment by security holders, lay in the achievement by American Fuel and its subsidiaries of an expanded market to be opened up by the Detroit pipeline. The realization of their hopes was forever destroyed by the activities of Columbia in assuming control of American Fuel system, terminating further pursuit of the Detroit plan and placing the companies in receivership."

By reason of Columbia's activities, the court determined that its securities must be subordinated to those of other creditors of every class of the American Fuel system (*id.* at 470). The instant petitions raise questions as to the maximum limits of this subordination.[4]

Substantially all the physical assets in the system are those held in Inland.[5] 72.6% of Inland's stock is held by American Fuel and 26% thereof is held by Kentucky Fuel. In recent years, Inland's properties

[4] The court had earlier indicated that Columbia's claims should be rejected. *In re American Fuel and Power Co.*, 122 F. 2d 223. Subsequent to the decision in *Columbia Gas & Electric Corp.* v. *United States*, 151 F. 2d 461, when subordination of Columbia's claims was first directed, the extent of the subordination of Columbia's securities has been involved in *Columbia Gas and Electric Corp.* v. *United States*, 153 F. 2d 101, certiorari denied, 329 U. S. 737; *In the Matter of Inland Gas Corp.*, 187 F. 2d 813; and *In re Inland Gas Corp.*, 211 F. 2d 381, certiorari denied, 348 U. S. 840; *In re Inland Gas Corp.*, 217 F. 2d 207.

[5] *In re Inland Gas Corp.*, 187 F. 2d 813, 819–820 (C. A. 6).

have greatly increased in value. Inland's first mortgage bonds, other than those held by Columbia, have been paid in the amount of approximately $2,650,000 principal and $2,600,000 interest. Also, more recently, the holders other than Columbia of Inland's second mortgage, which secured Inland's debentures and gold notes, have been paid in full by payments of approximately $1,530,000 principal and $2,236,000 interest. In addition, during the course of the proceeding, approximately $870,000 in interest was paid on the publicly held notes of American Fuel and approximately $400,000 was paid on Kentucky Fuel's bonds.

The remaining creditor claims against the debtors, including interest at the contract rate as of December 31, 1955, are as follows: [6]

	Principal	Interest	Total
INLAND			
Advances due American	$335,936	$573,674	$909,610
Claims of general creditors	10,167		10,167
6½% First Mortgage Bonds held by Columbia	1,671,054	2,610,965	4,182,019
7% Second Mortgage Debentures by Columbia	320,000	569,511	889,511
Unsecured claims for advances by Columbia	252,313	413,775	666,088
AMERICAN			
7% Gold Notes held by public	1,905,100	2,533,783	4,438,883
7% Gold Notes held by Columbia	60,000	107,100	167,100
6% Demand Notes held by Columbia	552,000	841,568	1,393,568
Unsecured claims of Columbia	17,000		17,000
KENTUCKY			
6¾% First Mortgage Bonds publicly held	2,236,600	3,316,692	5,553,292
6½% Debentures publicly held	542,000	901,300	1,443,300
6¾% First Mortgage Bonds held by Columbia	1,685,871	2,755,204	4,441,075
6½% Debentures held by Columbia	397,600	661,176	1,058,776
Unsecured claims for advances by Columbia	65,607	107,652	173,259

[6] These figures were obtained for the most part from the reports of February 25, 1956, of Eskew, Gresham & Dierson, certified public accountants of Louisville, Kentucky, filed in the

The determination below arose in connection with a plan proposed by the trustees for the sale of the assets of the system, other than cash, at an upset price of $8,000,000.[7] Under the plan, the public creditors of American Fuel would have been compensated in full and Kentucky Fuel's creditors would have received the balance of the system assets. This distribution would be in accordance with previous rulings of the court below (1) that, after payment of Inland's public creditors, American Fuel's and Kentucky Fuel's public creditors should be paid in proportion to their corporations' stock ownership in Inland,[8] and (2) that, after full payment of American Fuel's public creditors, all the assets of Inland should be applied to the payment of Kentucky Fuel's public creditors until they should be fully paid.[9] The plan was found by the Securities and Exchange Commission to be fair and equitable.

After adverse federal tax rulings indicated that the debtors' estates would be subject to substantial capital gains tax upon the sale of the assets, the Inland-Kentucky Fuel trustee petitioned the District

---

proceeding in the District Court. Where not so obtained, the figures as to principal may be found in the Commission's Corporate Reorganization Release No. 90 (1952), and subsequent interest has been computed at the contract rate.

[7] Although an $8,000,000 offer in existence at the time of formulation of the plan was withdrawn during the pendency of the appeals below, the trustees have not abandoned the sale proposal; and the problem involved here—the relative participation of various classes of claimants—will necessarily be involved in connection with any other plan.

[8] *In re Inland Gas Corp*, 187 F. 2d 813.

[9] *In re Inland Gas Corp.*, 211 F. 2d 381.

Court to adjudicate the tax consequences of the sale. The court held that it lacked jurisdiction to make such an adjudication (Pet. No. 342, p. 21).

The court also denied confirmation of the plan. The court's order states that (Pet. No. 342, pp. 21–22) "he was of opinion that the public holders of bonds and debentures of Kentucky Fuel Gas Corporation, being unsecured creditors, are not entitled to post-bankruptcy interest on their claims and that said plan is erroneous in allowing such post-bankruptcy interest, and for that reason, and for the further reason that the Court lacks jurisdiction and hence cannot pass upon the tax question presented by said petition of Ben Williamson, Jr., Trustee as aforesaid, and because of the uncertainty resulting from such undetermined tax question, the Court was of opinion that the plan should not be confirmed. * * * The Court then directed the Trustees herein to prepare and file a new Plan of Reorganization which will eliminate the recovery of post-bankruptcy interest by the public creditors of Kentucky Fuel Gas Corporation." Informally, the court also expressed the view that, after the payment of the principal of Kentucky Fuel's claims, the balance should go to Columbia. (See Appendix of Ben Williamson, Jr., Trustee, etc., filed June 29, 1956, in the court below "Tr. App.", p. 110.)

The Court of Appeals, one judge dissenting, affirmed the District Court's order. The court below also refused to grant a petition on behalf of American Fuel stockholders (petitioners in No. 241) urging the court to reconsider certain of its earlier determinations and reject Columbia's claims.

DISCUSSION

1. The petitions in Nos. 325, 326, and 342 present an important question in reorganization law which we believe has been improperly decided below.

(*a*) The decree of subordination against Columbia's claims did not by its terms exclude post-reorganization interest on the publicly-held claims of Kentucky Fuel's creditors. Nor was there any determination that the payment of principal was sufficient to compensate the Kentucky Fuel creditors for the harm inflicted upon them by Columbia's inequitable conduct. In 1945, when the court below decreed subordination, it stated that "[i]t was neither for the [District Court], nor is it for us to indulge in retrospective prophecy" and that subordination was required because "a restoration of the status quo ante is manifestly now impossible."[10]

The majority of the court below now holds that, since the Kentucky Fuel creditors' paramount claims against the Inland assets are unsecured, post-reorganization interest cannot be allowed *vis-a-vis* the subordinated claims of Columbia solely because of the so-called "bankruptcy rule" which, in its view, it is required to apply here under this Court's decisions in

[10] *Columbia Gas & Electric Co.* v. *United States*, 151 F. 2d 461, 469, 470 (C. A. 6). As noted in note 4, *supra*, the court below had originally felt that rejection was proper. See *In re American Fuel and Power Co.*, 122 F. 2d 223. Instead, it ordered subordination (which at that time appeared to achieve the same result) largely in deference to this Court's decision in *Hartford-Empire Co.* v. *United States*, 323 U. S. 386, although it has since indicated that the analogy to that case "is not as close as it then appeared to us to be." *In re Inland Gas Corp.*, 187 F. 2d 813, 815 (C. A. 6).

New York v. *Saper*, 336 U. S. 328, and *United States* v. *Edens*, 342 U. S. 912. In those cases, this Court held that federal and local taxes, although entitled to a priority over other unsecured claims under Section 64a (4) of the Bankruptcy Act (11 U. S. C. 104 (a) (4)), bore interest only to the date the bankruptcy petition was filed, not until payment. Hence the majority of the court below has determined that, even though the Kentucky Fuel creditors were deprived of their interest by reason of Columbia's wrongful acts, the remedy of subordination is not broad enough to permit them to receive that interest prior to payment to Columbia on its claims.

This determination conflicts in principle with decisions of this Court which have emphasized that the remedy of subordination is not to be so restricted that it cannot bring about an equitable result. In *Sampsell* v. *Imperial Paper and Color Corp.*, 313 U. S. 215, 219, this Court stated: "The power of the bankruptcy court to subordinate claims or to adjudicate equities arising out of the relationship between the several creditors is complete." See also *American United Mutual Life Insurance Co.* v. *City of Avon Park*, 311 U. S. 138, 146. In *Pepper* v. *Litton*, 308 U. S. 295, 305, it was made clear that the remedy of subordination, like other equitable remedies, is "invoked to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done". Subordination is used to undo so far as possible the wrong committed when a controlling person uses "his power for his personal advantage

and to the detriment of the stockholders and creditors no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements." *Id.* at 311. And see *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307.

Any limitation upon the "complete" power of a reorganization court to subordinate claims is of great importance in reorganization and bankruptcy proceedings, since problems whether and to what extent the securities of controlling persons should be subordinated arise with considerable frequency. They are bound to recur whenever a parent owns securities in its subsidiaries of a superior or equal rank to those held by the public.[11]

(*b*) The decision of the court below on the question of post-reorganization interest is in conflict with the decision of the Tenth Circuit in *In re Deep Rock Oil Corp.*, 113 F. 2d 266, certiorari denied, 311 U. S. 699, a reorganization case which arose under former Section 77B of the Bankruptcy Act. There, on prior review in *Taylor* v. *Standard Gas and Electric Co.*, 306 U. S. 307, by reason of the wrongful management and exploitation of the debtor by the parent (Stand-

[11] See, *e. g.*, cases cited at 3 Collier on *Bankruptcy* (14th ed.) ¶ 57.14, notes 6–7; ¶ 65.06, notes 1–2; and at 6 Collier on *Bankruptcy*, ¶ 9.15, note 16; and 1956 Cumulative Supplements thereto. The extent of the application of this remedy is by no means fully reflected in the reported cases, since, in various Chapter X cases where there is no court opinion, approved plans reflect a determination or compromise of contentions that a parent's claim must be subordinated. Problems of subordination have also arisen frequently in reorganizations under Section 11 of the Public Utility Holding Company Act of 1935.

ard), this Court had reversed a lower court judgment approving a compromise plan under which public security holders were not participating in full prior to participation by Standard on an open account. On remand, Standard contended that, even as a subordinated creditor, it should participate in Deep Rock's assets since there was an equity for it of over $2,000,000 if the paramount positions of the public noteholders and preferred stockholders should be limited respectively to the principal amount of the debt and the liquidating value of the preferred stock. In holding that Standard's claims were subordinated also to the interest and dividend arrearages, the Court of Appeals made clear that the noteholders were to be paid interest *to the time of payment.* It said (113 F. 2d at 269): "Where in the administration of the affairs of an insolvent corporation there are claims of different rank, the holders of prior claims are entitled to interest to the time of payment, even though the payment thereof may deprive the holders of subsequent claims of any participation in the funds of the bankrupt." [12]

Judge Miller, speaking for the majority below on this question, recognized that the *Deep Rock* case "lends some support" to the contention of the Ken-

[12] The debtor's assets were valued at about $17,000,000. The claim of the noteholders amounted to $10,000,000 in principal and $4,200,000 in unpaid interest, less an interim distribution of $1,200,000 as interest, or a net aggregate claim for $13,000,000. The liquidation preference of the stockholders amounted to $5,000,000 par value plus $3,150,000 in accumulated dividend arrearages, or an aggregate amount of $8,150,000. *In re Deep Rock Oil Corp.*, *supra*, 113 F. 2d at 267.

tucky Fuel creditors but stated that "such a contention appears to me to be expressly rejected" by this Court in *New York* v. *Saper*, 336 U. S. 328.

(*c*) The *Saper* case, however, is inapplicable here. *Saper* dealt only with tax claims, and the limitation upon the priority of these claims to principal under Section 64 (a) (4) of the Bankruptcy Act as against the claims of general creditors was expressly based upon an overriding Congressional mandate.[13] Neither the *Saper* case, nor related decisions,[14] purported to lay down a rule of distribution in respect

[13] In reviewing the legislative history as to the status of tax claims, this Court referred to the frequent expressions of "dissatisfaction over the inroads taxes and interest thereon make in the fund available for creditors" 336 U. S. at 329, note 5.

[14] Most of the cases cited by the majority below are, like *Saper*, tax cases. *United States* v. *Edens*, 189 F. 2d 876 (C. A. 4), affirmed, 342 U. S. 912; *United States* v. *General Engineering & Mfg. Co.*, 188 F. 2d 80 (C. A. 8), affirmed, 342 U. S. 912; *Pavone Textile Corp.* v. *Bloom*, 302 N. Y. 206, 97 N. E. 2d 755, affirmed *sub nom. United States* v. *Bloom*, 342 U. S. 912; *Commonwealth* v. *Thompson*, 190 F. 2d 10 (C. A. 1), certiorari denied, 342 U. S. 918; *Sword Line, Inc.* v. *Industrial Commissioner of the State of New York*, 212 F. 2d 865 (C. A. 2), certiorari denied, 348 U. S. 830; *National Foundry Company of New York* v. *Director of Internal Revenue*, 229 F. 2d 149 (C. A. 2).

In *United States* v. *Paddock*, 187 F. 2d 271 (C. A. 5), also cited in Judge Miller's opinion, it would appear that the disallowance of post-bankruptcy interest was based on equitable considerations. The case held that the Government was entitled to a priority against funds derived by the bankrupt from certain accounts receivable under an agreement with the bankrupt. The court noted that the agreement with the bankrupt did not expressly provide for interest; that the Government's claim was not "like a claim based on a promissory note that provides for interest"; and that the funds "did not draw interest or produce income in the hands of the trustee" (187 F. 2d at 276).

of post-bankruptcy interest which was to apply to all classes of unsecured creditors of different rank. The implication that the rule in the *Saper* case was to govern in the context of equitable subordination, and to supersede the equities which led to subordination, is even more remote.

Creditor claims do not lose "their interest-bearing quality" when bankruptcy or reorganization proceedings are instituted. See *American Iron and Steel Mfg. Co.* v. *Seaboard Air Line Ry.*, 233 U. S. 261, 266. Interest continues to accrue in the course of the proceedings and is allowed where no inequity results and certainly where equity so requires. For example, secured creditors are entitled to post-bankruptcy interest if the mortgaged assets or collateral security are

---

Neither *New York Trust Co.* v. *Detroit, T. & I. Ry. Co.*, 251 Fed. 514 (C. A. 6); *Squire* v. *American Express Co.*, 131 Ohio St. 239, 2 N. E. 2d 766; nor *Jamison* v. *Federal Deposit Insurance Corp.*, 149 F. 2d 199 (C. A. 5), which were also relied on by the majority below, involved questions of subordination by reason of inequitable conduct. The *New York Trust Co.* case held that in a receivership the priority of six-months claimants is limited to principal. The *Squire* case held that the priority of a depositor's preferred claim against an insolvent bank as against general creditors of the bank is limited to principal. In the *Jamison* case, subordination was provided for by the terms of the loan. Hence, when the assets were insufficient to pay all unsecured creditors in full, the contractual priority was limited to principal since "the delay in distribution is an act of the law * * * for which delay no interest by way of damages accrues" (149 F. 2d at 200).

In the remaining case relied upon by the majority below, *Application of Progress Shoe Co.*, 107 F. Supp. 114, 116 (E. D. N. Y.), the court held that the claims involved were on a parity and stated that "no showing has been made of any equitable considerations by which one creditor should be subordinated in payment to the other."

sufficient for that purpose.[15] This right is also accorded to secured creditors as against junior lienholders on the same mortgaged assets, even though as a consequence the junior lienholders may receive only a fraction of their principal.[16] Where the debtor becomes solvent, the surplus must be applied to interest accrued after the filing of the petition;[17] and a plan of reorganization cannot be fair and equitable if it provides for participation by stockholders and denies the bondholders accrued interest against the free assets of the debtor.[18]

These cases, though sometimes classified as exceptions to the bankruptcy rule, are really an affirmation that post-bankruptcy interest should be allowed

---

[15] *In re Macomb Trailer Coach Co.*, 200 F. 2d 611 (C. A. 6), certiorari denied *sub nom. McInnis* v. *Weeks*, 345 U. S. 958. See also *Coder* v. *Arts*, 213 U. S. 223, 228–229, 245; *Ticonic National Bank* v. *Sprague*, 303 U. S. 406, 412–413. Cases such as *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Company*, 318 U. S. 523, 572–573, where secured creditors did not receive full interest while unsecured creditors participated, involve situations where the mortgaged assets have been insufficient to cover the full claim and, as to the unmortgaged assets, secured creditors stand on equal footing with the general creditors. On the portion of their claim in excess of the mortgaged assets the courts have held that they share ratably with general creditors in the unmortgaged assets on the basis of principal only. See also *Sexton* v. *Dreyfus*, 219 U. S. 339.

[16] See *R. F. C.* v. *Denver & Rio Grande Western Railroad Co.*, 328 U. S. 495, 502–503 n. 6, 517. See also *American Iron and Steel Mfg. Co.* v. *Seaboard Air Line Ry.*, 233 U. S. 261, 267; *Central Trust Co.* v. *Condon*, 67 Fed. 84, 98 (C. A. 6).

[17] *Johnson* v. *Norris*, 190 Fed. 459, 463 (C. A. 5), appeal dismissed for lack of jurisdiction, 232 U. S. 715.

[18] *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 514–516, 520–521, 527.

to prior claimants where it is consonant with, or required by, the rule of absolute priority and the fair and equitable standard. As this Court said in *Vanston Bondholders Protective Committee* v. *Green,* 329 U. S. 156, 165, which arose in this very reorganization: "It is manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities between creditor and creditor or between creditors and the debtor." Accordingly, the issue in the instant case, as Chief Judge Simon stated, must be resolved "by balancing the equities as between Columbia and the Kentucky Fuel creditors who have waited so long for the payment of their claims." We submit that he properly concluded that earlier decisions as to the extent and character of Columbia's unconscionable conduct have long since resolved the equities in favor of the Kentucky Fuel creditors.

(*d*) The judgment below, insofar as it sustains the District Court's rejection of the plan's provision for post-reorganization interest and the District Court's direction to the trustees to propose a plan without such a provision, is undoubtedly "non-final" in the sense that the decision contemplates a remand for purposes of formulation of a new plan. Nevertheless, we believe that review by this Court would be appropriate at the present time. The Court has jurisdiction, 28 U. S. C. 1254 (1); and its decisions have emphasized that such jurisdiction will be exercised despite the interlocutory character of the judgment

where the judgment presents an important issue which is "fundamental to the further conduct of the case." See *United States* v. *General Motors Corp.*, 323 U. S. 373, 377; *Land* v. *Dollar*, 330 U. S. 731, 734, n. 2; *Larson* v. *Domestic & Foreign Commerce Corp.*, 337 U. S. 682, 685, n. 3. Particularly is this so if there is a conflict between circuits on the issue presented. *United States* v. *General Motors Corp., supra*, at 374. This is precisely such a case.

If we are correct in urging that the Kentucky Fuel creditors are entitled to post-reorganization interest, to require the formulation of a plan denying such interest is to require further needless litigation based on a plan which is defective at the outset. Thus, the interest question, already shown to be an important one generally in reorganization law (*supra*, pp. 11–12), is "fundamental to the further conduct of the case." And, as noted, the Sixth and Tenth Circuits are in conflict on the issue. Its definitive determination at this time would help immeasurably in bringing to a close what has been the longest reorganization to date under Chapter X.

2. (*a*) For the reasons stated, the Commission believes that Columbia's claims should be subordinated to the claims of the Kentucky Fuel creditors for post-reorganization interest as well as principal. In addition, in the event that the estate should prove large enough to yield a surplus after payment in full of the claims of the Kentucky Fuel creditors for post-reorganization interest as well as principal, the Commission believes that Columbia's claims should be further

subordinated to the claims of the stockholders.[19] To this extent we are in accord with the general position of the petitioners in No. 241, a committee of stockholders of American Fuel.[20]

As we have noted (*supra*, p. 8), when it appeared that there were sufficient assets fully to compensate the creditors of American Fuel, the court below held that all the remaining assets might be applied toward

---

[19] In *In re Inland Gas Corp.*, 187 F. 2d 813, 817, the court below, recognizing the inequity of any participation by Columbia in Inland's assets prior to payment of the public creditors of American Fuel and Kentucky Fuel, which together own 98.6% of Inland's stock, held that, after the payment of Inland's direct creditors other than Columbia, creditors of American Fuel and Kentucky Fuel, as "creditors or quasi-creditors of Inland," might participate in Inland's assets before Columbia. Accordingly, Inland's assets were to be siphoned up to these creditors of the holding companies in accordance with their respective stock interests in Inland. But the court refused to permit a similar participation to the 1.4% of the common stock of Inland not held by the holding companies on the ground that the holders thereof "were in no sense creditors." At that time, however, the value of Inland's assets was insufficient to compensate fully the creditors of ~~either~~ American Fuel ~~or~~ Kentucky Fuel. Thus, there was no disposition as to the relative rights of Columbia and the 1.4% group.

[20] The petition in No. 241 also seeks to have this Court review the reaffirmance by the court below of its 1953 determination permitting the creditors of Kentucky Fuel to be compensated from the assets of Inland applicable to American's stockholdings therein after the claims of American's creditors have been satisfied. See note 4, *supra*. There has been no attempt to make a record indicating the rel[illegible] equities as between the public creditors of Kentucky Fuel and American Fuel's stockholders. Nor is the factual context giving rise to the question as to the relative priorities of these security holders likely to recur in any subsequent reorganization. For these reasons, among others, the Commission does not believe that the question is an appropriate one for review by this Court.

the claims of Kentucky Fuel's public creditors. *In re Inland Gas Corp.*, 211 F. 2d 381. As a result of a continuing increase in Inland's assets, it now appears that the claims of Kentucky Fuel's public creditors, including post-reorganization interest, might be satisfied in full; and there will be a substantial surplus if post-reorganization interest is denied. The District Court has informally indicated that Columbia should take any surplus remaining (Tr. App. 110). In the Commission's view, such a disposition would be erroneous.

Columbia's improper activities in preventing the opening of the Detroit market for the gas produced by the system companies put an end to their hope of profits and hence were held to have adversely affected all security holders of the system.[21] Accordingly, equitable treatment requires that all receive compensation, including the common stockholders who have no "creditor status," [22] prior to any distribution to Columbia. No creditor status is necessary for application of the doctrine of subordination. See *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307, where subordination to preferred stock was required.

We recognize, of course, that subordination to common stock presents a novel problem and that the applicable judicial precedents deal with subordination to debt or preferred stock. That security holders injured by improper activities of one in control are the owners of common stock, which has an unlimited claim to assets, rather than the holders of securities

[21] *In re Inland Gas Corp.*, 187 F. 2d 813, 817; *In re Inland Gas Corp.*, 211 F. 2d 381, 384.

[22] Cf. *In re Inland Gas Corp.*, 187 F. 2d at 817.

with a limited claim, however, presents no justification for permitting a guilty controlling person to participate in the assets of a debtor prior to those it has injured. In appropriate circumstances, some limit to the extent of the subordination could be found. For example, if the maximum damage were computable, that could be the measure,[23] or it is possible that there might be situations where the original offering price to the public or the highest market price might be deemed proper. Where the opportunity for profit which was ended by the parent's improper activities appears to have been unlimited, subordination might properly be treated as the equivalent of disallowance. This Court has noted that both subordination and disallowance are equitable remedies to undo the wrong where control has been exercised "for the aggrandizement, preference, or advantage of the fiduciary to the exclusion or detriment to the *cestuis.*" *Pepper* v. *Litton*, 308 U. S. 295, 311.

The problem of subordination to common stock, it should be recognized, could arise in any reorganization where a controlling person has acted unconscionably to the injury of other common stockholders, as it has arisen in the past under the Public Utility Holding Company Act of 1935.[24] In addition, depending on the amount of future increments to the Inland estate, the problem may well have a substantial impact in this very proceeding.

---

[23] Cf. *In re Kansas City Journal-Post Co.*, 144 F. 2d 791, 800 (C. A. 8).

[24] See *The North American Company*, 33 S. E. C. 632, where this problem was the subject of a compromise.

(*b*) There is some doubt, however, whether the question of subordinating Columbia's claims to stockholder claims is properly presented here.

The petition in No. 241 (p. 4) "seeks review of the judgment of the Court of Appeals dismissing a petition in that court by these petitioners to permit them to propose provisions of a plan of reorganization of the debtors which will require modification of earlier judgments of the Court of Appeals." The proposed provisions would (i) reject or subordinate the claims of Columbia to the claims and stock interests of all other security holders of the debtors, and (ii) apply the assets of each of the debtors first to paying its own creditors and thereafter to its own stockholders before paying the creditors of the other debtors.[25] In denying the petition—in essence a motion for rehearing—the court below referred only to the latter proposed provision (Pet. No. 342, p. 34). As a consequence, there is no basis for assuming that the court below passed on any question relating to the relative priorities of Columbia and the stockholders. Ordinarily, where an out-of-time petition for rehearing is denied by a lower tribunal without an express disposition of the question raised, it is presumed that there was no adjudication of the question. See *Pfister* v. *Northern Illinois Finance Corp.*, 317 U. S. 144, 149–150; *Bowman* v. *Loperena*, 311 U. S. 262, 266. And cf. *Securities and Exchange Commission* v. *Louisiana Public Service Commission*, 353 U. S. 368.

But, regardless of whether the question of the relative priorities of Columbia *vis-a-vis* the stockholders

[25] See note 20, *supra*.

is properly before the Court on the independent basis advanced by the petitioners in No. 241, there would seem to be no barrier to this Court's consideration of the matter in the event that it grants certiorari in Nos. 325, 336, and 342 to review the question concerning post-reorganization interest for the Kentucky Fuel creditors. Indeed, since the extent of Columbia's subordination is common to both questions, the adjudication of the issue relating to the Kentucky Fuel creditors will necessarily touch on the issue relating to the stockholders. In these circumstances, it would appear appropriate to grant review in No. 241 as well as in Nos. 325, 336, and 342.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petitions in Nos. 325, 336, and 342 should be granted, and, in such event, that the petition in No. 241 should be granted limited to the question whether there should be subordination of Columbia's claims to the interests of common stockholders of American Fuel.

J. LEE RANKIN,
Solicitor General.

THOMAS G. MEEKER,
General Counsel,
DAVID FERBER,
Assistant General Counsel,
AARON LEVY,
Special Counsel,
Securities and Exchange Commission.

AUGUST 1957.

U. S. GOVERNMENT PRINTING OFFICE: 1957